Air Canada Stock: Should Investors Buy or Sell Now?

Description

Air Canada (TSX:AC) rallied in late 2020 on positive COVID-19 vaccine news. Investors who missed the surge want to know if Air Canada stock is still cheap and will soar in 2021 or trades too high and risks crashing back to the 12-month lows.

COVID threat to Air Canada stock

Slow vaccine rollouts and surging COVID-19 cases will keep travel restrictions in place for several months. In fact, many countries are now seeing record daily COVID-19 cases with governments implementing new lockdowns.

In Canada, British Columbia is seeking legal advice on the possibility of implementing a travel ban on visitors from other provinces. Holiday travellers caused a spike in COVID-19 cases at B.C. ski resorts. The move also comes as the province searches for ways to control the spread of new variants of the virus from the U.K. and South Africa that are now present in Canada.

Any agreement among the provinces to shut down domestic travel would hurt Air Canada and the stock price.

On the international side, flight restrictions will likely remain in place until the fall. Canada says most citizens who want a vaccine will have access to one by the end of September. That might be the timeline for lifting the current travel ban. The government just imposed tighter restrictions on those who are allowed to travel to Canada. A negative COVID-19 test within the past 72 hours is now required before a person can board a plane headed to the country.

Air Canada cash burn

Air Canada anticipated net cash burn of $1.1-1.3 billion for Q4 2020 when it reported Q3 results. That's $12-14 million per day. The airline recently announced another 25% cut to capacity resulting in the loss of 1,700 more jobs. Air Canada reduced staff by 20,000 in June.

The company says the new travel restrictions pertaining to COVID tests had an "immediate impact" on bookings. Expanded capacity cuts indicate the dire situation as management tries to reduce cash burn. Air Canada finished Q3 2020 with cash and cash equivalents of $7.8 billion.

Investors should keep a close eye on the Q4 2020 results to see if net cash burn exceeded expectations and to watch for guidance on the cash situation in the first half of 2021. Air Canada stock could tank if cash burn jumps significantly.

Ongoing risks

Uncertainty surrounding travel restrictions is the main headwind. However, investors holding Air Canada stock need to consider other threats.

Air Canada began bailout negotiations with the government two months ago. The prime minister indicated a deal depends on ticket refunds for cancelled fights and a commitment to maintaining flights to smaller cities across the country. Pundits speculate any aid could also have carbon-reduction terms.

International airlines received more than US$160 billion in government assistance in 2020, so there will likely be a package specifically designed for Air Canada and its Canadian peers. Investors have propped up Air Canada's stock price partly on the hopes of a rescue, but the terms are important. The government requirements might have a negative impact on profitability.

High fuel prices also threaten to derail the recovery. Jet fuel makes up at least 15% of an airline's expenses. WTI oil surged from US$37 per barrel in November to the current price above US$50. That will filter through to higher fuel prices, as refineries face more expensive crude oil feedstock.

Should you buy Air Canada stock now?

Management has done a good job of raising capital and reducing costs to navigate the storm. As a result, Air Canada's balance sheet is in better shape than most of its international competitors. The airline will make it through the pandemic and eventually recover.

However, the stock appears overpriced at $23 per share given all the near-term challenges and uncertainty. Investors who bought Air Canada stock around $15 should consider booking profits. Those who missed the rally might get another chance to buy at a better entry point.

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